Unitil
Unitil Service Corp.

April 7, 2006

HAND-DELIVERED

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd floor
Boston, MA 02110

Re: Response of Fitchburg Gas and Electric Light Company d/b/a Unitil to the Request for Comments D.T.E. 06-28

Dear Secretary Cottrell:

Pursuant to the Department of Telecommunications and Energy's ("Department") Request for Comments issued in the above-referenced docket on March 21, 2006, Fitchburg Gas and Electric Light Company d/b/a Unitil ("Unitil" or "Company") provides the following response.

Introduction

On February 24, 2005, Unitil submitted a request that the Department approve a change in the methodology by which the Company currently recovers its electric supply-related bad debt costs through its default service tariff. Unitil requested that it be authorized to flow-through its actual uncollected costs associated with electric supply. Unitil made this filing in response to the Department's order with respect to Bay State Gas Company ("Bay State") in D.T.E. 05-27, issued on November 30, 2005, which allowed for an amended Bad Debt Cost Factor, a component of the Cost of Gas Adjustment Clause ("CGAC"). Unitil also requested approval of the recovery of its under-recovered electric supply cost-related bad debt for calendar year 2005. Similar relief for its gas division has been requested by Unitil in docket D.T.E. 05-GAF–P4.

As discussed in Unitil's February 24, 2006 filing letter, D.T.E. 05-27 provided for a revised method for the allocation of gas cost-related bad debt to the CGAC, allowing for the recovery of actual costs. This

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order reversed the Department's decision in D.T.E. 02-24/25, which had limited Unitil's gas cost and electric supply cost-related bad debt recovery to a fixed level of bad debt.

On March 21, 2006, the Department issued a Request for Comment in this docket containing two briefing questions that are related to Unitil's request.

Briefing Question No. 1: Is the referenced case applicable where a change in Department policy, as opposed to an error in calculation, occurs?

In its February 24, 2006 filing, Unitil cited to Fitchburg Gas and Electric Light Company v. Department of Telecommunications and Energy, 440 Mass. 625 (2004) in support of its request to collect its 2005 under-recovered electric supply cost-related bad debt through its default service tariff. Unitil submits that recovery of these amounts would not constitute retroactive ratemaking, because, as decided in Fitchburg, the limitations on retroactive ratemaking applicable to base-rate changes do not apply to reconciling mechanisms.

In Fitchburg, Unitil appealed a Department determination that the company overcharged its gas customers by including inventory finance charges (IFCs) in both its base rate and its CGAC. The Department had ordered the company to refund the overcharge initially collected via the CGAC back through CGAC to its ratepayers. On appeal, the Massachusetts Supreme Court considered whether the Department's refund order constituted retroactive ratemaking. The Supreme Court concluded that an order retroactively adjusting a CGAC "is well within the department's general supervisory authority over utility costs. . . . and is consistent with its 'broad authority to determine ratemaking matters in the public interest.'" *Id.*, at 637 (citations omitted).[1]

The Department questions whether the Supreme Court's determination in Fitchburg that a retroactive adjustment of a CGAC is

[1] "Retroactivity is inherent in the very nature of a CGAC. Unlike the base rate, which is a calculation of rates going forward based on historical data, the CGAC adjusts semi-annually for utility costs as they actually have been incurred, according to a mechanically applied technical formula." *Id.*

permissible is applicable to situations where the *purpose* of the reconciling mechanism's retroactive adjustment is to implement a change in Department policy.

The rule against retroactive ratemaking is essentially a rule against retroactively altering base rates, and exists as a matter of statutory construction of G.L. c. 164, §94. *Id.* Reconciling clauses such as the CGAC and the default service tariff have a distinct legal basis, and have been distinguished based upon their design as flexible instruments to enable companies to recover the actual cost of the commodity purchased. It is expected that changes will be made to a reconciling clause to adjust for under-or over-collections once actual cost figures, rather than estimates, are available. Blackstone Gas Co., D.P.U. 511 (1981). Moreover, the Supreme Court noted in Fitchburg that the amounts recovered through the CGAC represents costs over which utilities have little or no control, and it would defeat the purpose of the clause to require that these costs be frozen until a rate investigation is completed. *Id.* at 638. This applies to Unitil's electric supply purchases as well. Unitil's purchases of energy supply for default service are accomplished pursuant to Department approved market solicitations, and it has no effective control over the prevailing conditions or prices in the wholesale market. Unitil must purchase default service supply to meet the demand of the customers it is obligated to serve.

Whether the retroactive application of a new Department policy through the default service tariff would be a violation of the general prohibition against retroactive ratemaking or be allowable as an accepted retroactive application of a reconciling mechanism would be dependent upon the nature of the policy change: is it to effect a "base rate" type change or is it more of an adjustment to correct the calculation of the default service tariff so that it more closely recovers the actual costs. Unitil submits that the rule against retroactive ratemaking would not be violated by the retroactive application of a revised default service tariff so as to allow the Company to recover its 2005 electric supply cost-related bad debt costs. This is because the clause would be employed solely to correct for past under-recoveries of these amounts and thereby recover the company's actual default service costs. This type of adjustment is, as expressed in Fitchburg, "inherent in the very nature" of a reconciling mechanism. *Id.*

There is additionally, however, a Constitutional dimension to this issue, as has been explicitly recognized by the Department in D.T.E. 05-66: the right of a regulated company to be given an adequate opportunity to recover the reasonably incurred costs of providing required service so as to preserve its financial integrity and attract capital. The Department found that the extreme wholesale gas prices coupled with the unintended effects of the bad debt recovery methodology put in place in D.T.E. 03-40, as a result of its decision in D.T.E. 02-24/25, effectively denied Keyspan its constitutionally protected opportunity to earn a reasonable return. In doing so, the Department determined that the constitutional infirmity was inherent in the methodology it had put in place in D.T.E. 03-40, and the recovery through the CGAC from that point forward had been insufficient to provide an adequate opportunity to earn a reasonable rate of return. It was, therefore, not sufficient to simply provide for a prospective change of the methodology of bad debt collection. "The matter has also been raised here in D.T.E. 05-66 *and must be answered.*" D.T.E. 05-66 at 16 (emphasis supplied.) Keyspan's recovery of its under-recovered bad debt amounts as an exogenous cost to its rate plan was therefore necessary to remedy the constitutional defect in its CGAC.

The same analysis is applicable to Unitil: the Department has already determined that the bad debt methodology that Unitil was directed to apply in D.T.E. 02-24/25 is incompatible with constitutionally sound regulation because it denies recovery of costs which are necessary to meet service obligations and which are largely beyond the company's control. Since this infirmity is inherent in the bad debt recovery method itself, which has been in place since the last rate order, it is not sufficient to limit Unitil's remedy to the prospective recovery of its actual default service related bad debt costs, particularly when it has experienced large under-collections of these amounts. Thus, retroactive application of a revised default service tariff is not merely permissible under Fitchburg and consistent with the purpose of a reconciling clause, it is required to remedy the same constitutional defect in Unitil's default service tariff as was found in Keyspan's CGAC.

There can be no question that wholesale power supply costs have been and remain beyond the control of Unitil. Unitil must purchase electric supply to meet the default service requirements of its

customers and has no control over the prevailing conditions or prices in the wholesale market. Unitil's default service supply costs have been well within the range of costs charged by utilities within Massachusetts, and its customers have experienced the same price volatility and extreme prices as other utilities' customers. Further, as discussed in its February 24, 2006 filing, Unitil has prudently managed its default service supply purchases and has successfully kept its bad debt costs within reasonable levels.

Under these circumstances, Unitil submits that the retroactive application of a revised electric supply bad debt cost recovery methodology through the default service tariff not only permissible, but is necessary to avoid denying Unitil its constitutionally protected opportunity to earn a reasonable return.

However, the issue the Department poses - whether Fitchburg's approval of a retroactive adjustment of the default service mechanism is applicable where a change in policy occurs - need not be reached in this case in order to approve FG&E's request, as no policy change will occur. The Department's initial decision to require electric distribution companies to allocate a portion of bad debt to the calculation of default service prices was made in D.T.E. 02-24/25 for Unitil (*Slip Op.* at page 171), and applied to all distribution utilities in D.T.E. 02-40-B. (*Slip Op.* at page 17). This policy remains in place. A representative level of uncollectible expense is included in base rates, and that remains unchanged. What will occur is very limited: the portion of uncollectible expense allocated to the default service tariff would be revised to allow a flow-through and reconciliation to actual costs. As stated above, retroactive application of this tariff would not be prohibited by Fitchburg, and is consistent with the very purpose of the reconciling nature of the default service tariff.

Briefing Question No. 2: When the Department approves a new method for calculating costs, does the default service tariff's reconciling mechanism permit recovery of costs resulting from that new method on a retroactive basis?

Yes. The Department has often provided for retroactive application of such new or revised reconciling mechanisms. For example, in D.T.E. 99-32, issued September 15, 1999, the Department

authorized Unitil to implement its proposed methodology for the financing of gas costs effective as of November 30, 1998, over ten months prior to the date of the order. The Department determined that since Unitil had removed inventory financing charges from its CGAC on December 15, 1998, and therefore had not recovered these expenses since November 30, 1998, it would permit the Company to reconcile the actual costs incurred since that time at the time of its next peak CGAC filing. The Department stated that this recovery was consistent with the reconciliation purpose of the CGAC and was not retroactive ratemaking.

More recently, in D.T.E. 01-106-C, the Department approved the establishment of a Residential Assistance Adjustment Factor ("RAAF") for gas and electric distribution companies. Through the RAAF, a distribution company collects the difference between the distribution revenue for the usage of customers under the low-income discounted rate and the regular residential rate. The order established a baseline amount calculated as the difference between the base rate revenues that would have been collected from customers receiving the low-income discount during the year ending June 30, 2005, had no low-income discount existed, and the actual base rate revenues collected from low-income customers for the twelve months ending June 30, 2005. On or after July 1, 2005, however, the amount of the low-income discount in excess of the baseline amount became eligible for recovery through the RAAF, though the RAAF itself was first approved by order on October 14, 2005.

Similarly, in D.T.E. 03-47, issued on December 24, 2003, the Department approved NSTAR's request for a new reconciling mechanism for the recovery of pension and PBOP costs, and permitted the recovery of such expenses incurred during calendar year 2003, adjusted for any previously unamortized balances. (NSTAR was directed to exclude the first eight months of 2003 from the reconciliation adjustment, however, because they were under a rate freeze during that portion of the year, and the Department determined that allowing the recovery of such costs during that period would contravene the intent of the freeze.)

In sum, Unitil's request to recover its actual electric supply-related bad debt costs beginning January 1, 2006, and to recover its 2005 under-recovered electric supply–related bad debt costs is

consistent with Department precedent, Constitutional requirements and the treatment of similar costs authorized by the Department for Keyspan and Bay State.

Conclusion

For the reasons discussed above, Unitil submits that the default service tariff's reconciling nature permits the retroactive recovery of costs resulting from the application of a revised cost calculation in instances where such costs are necessary for the provision of service, are beyond the control of the company, and where the incurrence of these costs by the utility has been reasonable.

Respectfully submitted,

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cc: Carol Pieper, Hearing Officer
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